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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 246

NATHAN FRED MARKS, *Petitioner,*

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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The petitioner Nathan Fred Marks respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on March 5, 1968.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 391 F. 2d 210 and is reprinted in Appendix A hereto, p. 1a, *infra*. The order of the District Court denying the motion for judgment of acquittal or for a new trial is not reported; it is reprinted in Appendix B hereto, p. 5a, *infra*.

JURISDICTION

The judgment of the Court of Appeals was entered on March 5, 1968, and a timely petition for rehearing was denied on May 1, 1968. On May 20, 1968, Mr. Justice Douglas signed an order extending the time for filing this petition for writ of certiorari to and including June 29, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether, in a prosecution for tax evasion under 26 U.S.C. § 7201, the Government in a specific item case has the burden of proving that the understated tax obligation is substantial in amount.

2. Whether, in a prosecution for tax evasion under 26 U.S.C. § 7201, the Government has the burden of proving the relevant tax rates so that the jury may properly calculate the tax due on what it finds to be unreported taxable income and assess the substantiality of the tax so calculated.

3. Whether the substantial understatement requirement, for purposes of 26 U.S.C. § 7201, relates to (a) the substantiality of the understated tax, (b) the comparison of the tax found to be due to that which was alleged to be due, or (c) a consideration of any and all other factors that the jury may wish to consider.

4. Whether a tax understatement of $375.49 can be considered substantial where (a) the evidence as to unreported income was closely divided, (b) the indictment alleged that the understated tax amounted to $3,350.45, and (c) the jury was unable to assess the substantiality of the $375.49 understatement due to the Government's failure to calculate and submit the proper tax understatement and the Government's failure to submit the tax rates appropriate to the calculation of the proper tax.

STATUTORY PROVISIONS INVOLVED

United States Code, Title 26, Section 7201:

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution."

STATEMENT OF THE CASE

On February 25, 1966, an indictment in three counts was filed against the petitioner in the United States District Court for the District of Oregon, charging that he had willfully attempted to evade a "large part" of his federal income taxes for the years 1961, 1962 and 1963 by filing fraudulent returns for those years, in violation of 26 U.S.C. § 7201. After a jury trial lasting over five days, the petitioner was found not guilty on Counts II and III, covering the 1962 and 1963 tax years, but he was found guilty as to Count I, covering the 1961 tax year. On November 25, 1966, the District Court sentenced petitioner to five years imprisonment

on condition that he be confined in a jail-type institution for four months, the remainder of the sentence being suspended and the petitioner placed on probation. The Court of Appeals affirmed the judgment of conviction.

As the Court of Appeals noted, Appendix A, p. 2a, *infra,* this was not a net worth case. It was premised on the omission of specific items of income from petitioner's 1961 tax return. And the Government conceded below that it had the burden of establishing (1) a *substantial* tax deficiency and (2) a willful attempt by petitioner to evade and defeat that tax. Brief for the United States in the Court of Appeals, p. 28.

Petitioner's 1961 tax return reported no taxable income, after making deductions from the reported gross income, and hence indicated that no tax was due. The indictment, however, charged that petitioner had a taxable income in 1961 of $14,101.60 and that the tax due thereon was $3,350.45. But as the case was submitted to the jury, the Government's claim of unreported income had been reduced by its own figures to $2,099.81, on which only $419.96 of tax was allegedly due (E. 155). Yet even these figures were erroneous on the face of the calculations. In the language of the Court of Appeals, in footnote 1 of its opinion (Appendix A, p. 1a, *infra*), petitioner was "clearly entitled to an additional deduction of $222.38 for medical expenses" and the Government "should have contended that the net taxable income was $1,877.43 and that the tax was $375.49." The difference between what was claimed by the Government before the jury and what the Government should have claimed was termed "de minimis" by the Court of Appeals.

Moreover, the only proof offered by the Government and the only evidence before the jury as to the precise amount of the tax deficiency was in terms of the erroneous $419.96 figure. Testifying from the improperly calculated Exhibit 155,[1] the Government's expert witness stated that as to petitioner's 1961 tax year "the taxable income therefore is $2,099.81, and the income tax liability on that amount is $419.96."[2] Tr. 913. But the Government offered no testimony or proof, and the jury was not instructed, as to the tax rates applicable to one having a taxable income of the stated amount and possessing the tax status of the petitioner. In making his contentions and calculations on the appeal below, however, petitioner was "willing to concede that under the circumstances shown by the evidence, the applicable tax rate for 1961 is most likely 20%, which

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[1] Exhibit 155 was a summarization of Exhibit 150, which reflected the Government's attempt to reconstruct what it conceived to be a proper tax calculation for 1961. But the tax was calculated on an alleged net income of $2,099.81, which in itself was an inaccurate figure in light of the Government's own proof. That net income was arrived at by erroneously deducting only $504.44 in medical expenses, whereas the correct deduction was $726.82—a difference of $222.38.

Moreover, petitioner claimed below that Exhibit 150 contained other inaccuracies in computation. Dependent upon certain deductions and carry-overs, it was possible to compute the taxable income as $1,349.38 and the tax thereon as $269.98; and by another computation it was possible to arrive at no taxable income and no tax deficiency.

[2] The Government's expert witness further testified that as to 1962 the taxable income appeared to be $9,866.49, as to which there was an unreported tax liability of $2,165.28, and that as to 1963 there appeared to be a taxable income of $2,709.65, as to which the unreported tax liability was $541.93. Tr. 914. But the petitioner's acquittal as to those tax years indicated that the jury chose not to accept this tax expert's calculations for 1962 and 1963.

rate has been employed herein." Petitioner's Brief in Court of Appeals, p. 13.[3]

In order to arrive at the claim that $2,099.81 (or even the more correct figure of $1,877.43) of taxable income had not been reported in 1961, the Government was required to contend and prove that each of four specific items was unreported income received in 1961 by petitioner:

Source	Amount
(1) Glenn Morningstar	$ 755.00
(2) Rudy Gross	750.00
(3) Ford M. Converse	840.00
(4) Floyd Persons	4,000.00

The Government's theory was that these items were either compensation for services renderd by petitioner or money obtained by him under false pretenses. On the other hand, petitioner contended that these items were all loans, not income. And the Court of Appeals conceded (Appendix A, p. 2a, *infra*) that "to some extent the face of the items confirmed the explanation" offered by petitioner.

The Court of Appeals further acknowledged (Appendix A, p. 2a, *infra*) that if petitioner could "knock out the fourth item he would owe nothing" and that if he could "knock out any two of items (1) to (3), the deficiency could hardly be called substantial." Extensive and conflicting testimony concerning the nature of these four items was presented but obviously the jury

[3] To the above-quoted sentence in petitioner's brief below was appended the following footnote: "This rate appears to be correct under Sections 1 and 2, IRC, and Regulation § 1.2-1 in force in 1961 as shown by Vols. 1 and 3, Prentice-Hall, Federal Taxes, 1961, paragraphs 4041, 4043 and 17.011 A."

chose to believe the Government's version. Yet the evidence supporting petitioner's version was so rational and strong that the Court of Appeals conceded (see Appendix A, p. 2a, *infra*) that "Certainly, without violating its oath, the jury could have found the defendant not guilty"—as it did in fact find as to the 1962 and 1963 tax years.

In the instructions to the jury, to which the petitioner made no objections, the District Court charged in pertinent part as follows (Tr. 940-949):

> "It is not necessary that the Government establish that the amount of income received and the amount of tax owing were exactly the amounts alleged in the various counts of the indictment. The precise amount of the tax is not the gist of the offense. It is sufficient if the Government proves beyond a reasonable doubt that there was a wilful and knowing attempt to evade a substantial part of the income tax due as alleged in each of the counts in the indictment.
>
> "Now, the meaning of the word 'substantial,' as here used, depends upon the facts, circumstances, and conditions as shown by the evidence as to each particular count. Any amounts of unreported taxable income or tax greater than sums relatively small, under the particular circumstances pertaining thereto, are substantial.
>
> "Any amounts of unreported taxable income or taxes should be disregarded which reasonably may be accounted for as due to error, oversight, or as reasonably considered inconsequential by a taxpayer.
>
> "To establish the first element of the offense charged in each count, namely, the receipt by the defendant of unreported income upon which a substantial amount of tax was due and owing, the

Government has presented evidence under what is commonly known as the 'specific item' method of proof. This method simply consists of offering evidence of particular or specific amounts of taxable income received by the defendant during a particular tax period, with evidence that the taxpayer did not include such amounts in his tax return for such period, together with evidence concerning defendant taxpayer's knowledge of the omission and his specific intent and wilfulness in attempting to evade payment of the tax by the omission.

"The first step in arriving at the income of an individual upon which a tax is imposed is a determination of the gross income of the individual, which I will define for you in a few moments.

"After having determined the gross income of the individual, the next step provided by the statutes for arriving at the income upon which the tax is computed is to deduct from the so-called gross income such deductions as the statutes permit . . . .

"I will now define for you what constitutes taxable income and, in so doing, I will enumerate, as far as pertinent to this case, those receipts which are nontaxable . . . .

"Now, the critical issue in this case, members of the jury, is whether certain funds were borrowed by defendant from various persons and hence constitute loans, as that term will be defined in a few moments. . . .

"In this case you have heard the testimony of expert witnesses. This class of testimony is proper and competent evidence . . . [but] it is entirely within your province to say what weight shall be given them. You are not bound by the testimony of experts, and the testimony of such experts is to be canvassed and weighed as that of any other witness."

Following the jury verdict of guilty as to Count I, covering the 1961 tax year, the petitioner filed a motion for judgment of acquittal or, alternatively, a motion for a new trial. Petitioner there urged that the Government had failed to discharge its burden of proof because the evidence showed that in fact no tax was owing in 1961. He further claimed that because the jury had not been informed of the applicable tax rate to be applied to any alleged deficiency the jury had no way of determining from the evidence what, if any, tax was due or, if there was a tax due, whether or not it was substantial. As to the latter claim, petitioner asserted that the Government, in satisfying its burden of proof, must supply information as to the tax rate and as to the substantiality of the tax deficiency so as to make its evidence of alleged taxable income meaningful.

The District Court denied the alternative motions, stating in a memorandum opinion (see Appendix B, pp. 5a-8a, *infra*) that (1) the question as to the failure to submit to the jury the applicable tax schedules and rates, not having previously been raised by petitioner in the form of requested instructions or otherwise, came too late for consideration, and (2) there was substantial evidence on which the jury could find that petitioner had "willfully failed to report over $2,000.00 in taxable income on this particular count" and "Of course, the tax on such unreported income would be substantial." See Appendix B, p. 7a, *infra*.

The Court of Appeals subsequently affirmed the judgment of conviction as to Count I, after noting the erroneous calculations submitted to the jury by the Government and finding that the unreported taxable income was only $1,877.43 and the resulting tax only $375.49.

REASONS FOR GRANTING THE WRIT

The decision below reflects an important and recurring problem in the administration of the federal criminal tax laws, a problem that warrants attention and resolution by this Court.

Basically at issue is the nature and extent of the Government's obligation, in prosecuting alleged evasions of federal income taxes, to establish a "substantial" understatement of the tax obligation. Section 7201 of the Code makes no specific reference to any requirement of substantiality as to the evaded tax; it simply proscribes any willful attempt "to evade or defeat any tax." But many lower courts, including those that adjudicated this case, have read such a requirement into Section 7201, although the various formulations of that requirement have not always been clear or consistent.[4] And while this Court has never

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[4] See, for example, the following cases:

(1) *Steinberg* v. *United States*, 14 F. 2d 564, 565 (C.A. 2): "proof of any substantial excess over his reported income was sufficient."

(2) *Tinkoff* v. *United States*, 86 F. 2d 868, 878 (C.A. 7): "It is sufficient if any substantial portion of a tax was defeated or evaded."

(3) *United States* v. *Nunan*, 236 F. 2d 576, 585 (C.A. 2): "The showing by the government must warrant a finding that the amount of the tax evaded is substantial."

(4) *Sherwin* v. *United States*, 320 F. 2d 137, 151 (C.A. 9): "the Government must establish beyond a reasonable doubt that there was a substantial amount of federal income tax due from the defendant for the particular years covered by these accounts."

(5) *Leeby* v. *United States*, 192 F. 2d 331, 334 (C.A. 8): "all that it was necessary to show was that there was omitted from the reported income a substantial amount."

(6) *Watts* v. *United States*, 212 F. 2d 275, 277 (C.A. 10): "To make a case for the jury, it was sufficient that the Government

had occasion to rule on the requirement, it has made passing references to "substantial amounts" of unreported income that justified convictions. *United States* v. *Ragen,* 314 U.S. 513, 521; *United States* v. *Johnson,* 319 U.S. 503, 517; and see *Holland* v. *United States,* 348 U.S. 121, 126.

In this case the petitioner was charged with having evaded a "large part" of his 1961 income tax; he was convicted on the theory that his 1961 tax deficiency was substantial; and his conviction was affirmed on the finding that the deficiency of $375.49 was substantial. Moreover, the Government conceded below that it was obligated to prove a substantial tax deficiency. This case thus presents an appropriate vehicle for exploring and shedding much-needed light on the concept of substantiality. More particularly, the problems exposed by the ruling below may be stated as follows:

I

What is the nature of the substantial understatement requirement? The court below seemed to treat it as a substantial amount of tax due and owing, but other courts have framed the concept in terms of a substantial amount of unreported income (e.g., *Watts* v. *United States,* 212 F. 2d 275, 277 (C.A. 10)), or in terms of an evasion of a substantial portion of the tax due (e.g., *Tinkoff* v. *United States,* 86 F. 2d 868, 878 (C.A. 7)), or simply in terms of "some tax due" over and above

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introduce evidence from which the jury could find that a substantial amount of net income was not reported and that the failure to so report it was wilful and intentional."

See other cases collected in Lipton and Petrie, *The Substantial Understatement Requirement in Criminal Tax Fraud Cases,* 19 Institute on Federal Taxation 1175 (1961).

the amount returned and paid (e.g., *Gleckman* v. *United States,* 80 F. 2d 394, 396 (C.A. 8)).

To add to the confusion, the District Court below in its memorandum opinion (Appendix B, p. 6a, *infra*), seemingly adopted the view that the Government's case is made when there is "substantial evidence from which the jury could find that a substantial amount of net income was not reported and that the failure to so report was willful and intentional." Apart from the problem of whether "substantial evidence" is an adequate substitute in a criminal case for proof "beyond a reasonable doubt," the District Court then added the inconsistent thought that "the amount of the additional income tax is not the important feature as long as it was a substantial sum." *Ibid.* Moreover, the court's announcement that it is enough that there be substantial evidence of a substantial amount of net income is entirely inconsistent with its charge to the jury that there must be proof beyond a reasonable doubt that "there was a wilful and knowing attempt to evade a substantial part of the income tax due as alleged . . . in the indictment." Tr. 940.

It should be made clear by this Court precisely what it is that must be substantial for purposes of proving a crime under Section 7201, and what the burden of proof is in relation thereto.

II

Does the substantial understatement requirement apply to specific item cases, such as the instant one? It was urged by the Government below, in reliance on a District Court opinion, *United States* v. *Cindrich,* 140 F. Supp. 356, 359-360 (D.C. Pa.), aff'd 241 F. 2d 54 (C.A. 3), that it is not necessary in specific item cases

to prove a substantial understatement of income or tax; such proof, the *Cindrich* opinion indicated, is necessary only where income is approximated, as in net worth cases. But many other courts have recognized and applied the rule in specific item situations. See, e.g., *United States* v. *Schenck,* 126 F. 2d 702, 704 (C.A. 2); *United States* v. *Smith,* 206 F. 2d 905, 910 (C.A. 3). And courts have frequently mentioned the requirement in net worth cases without suggesting that application of the rule is limited to such cases. See, e.g., *Leeby* v. *United States,* 192 F. 2d 331, 334 (C.A. 8); *United States* v. *Norris,* 205 F. 2d 828, 829 (C.A. 2). Only this Court can resolve this conflict.

III

What is "substantial" within the meaning of the substantial understatement rule? The jury in the instant case was instructed that the meaning of the word "substantial" depends upon "the facts, circumstances, and conditions as shown by the evidence." Tr. 941. Such an instruction was consistent with the ruling in *United States* v. *Nunan,* 236 F. 2d 576, 585 (C.A. 2), that "substantially" is "not measured in terms of gross or net income nor by any particular percentage of the tax shown to be due and payable. All the attendant circumstances must be taken into consideration."

But it has been noted that such a definition of "substantial" virtually emasculates the substantial understatement rule.[5] By discarding the relationship of the tax actually understated to the tax as reported by the taxpayer or to the tax alleged in the indictment, as well

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[5] Lipton and Petrie, *The Substantial Understatement Requirement in Criminal Tax Fraud Cases,* 19 Institute on Federal Taxation 1175, 1189 (1961).

as the relationship of the omitted income to both gross and net income, this view of "substantiality" effectively eliminates the most relevant of the otherwise undefined "attendant circumstances"—all of which purportedly are to be considered. Perhaps in recognition of that fact, other courts have emphasized the percentage factor in giving content to the meaning of "substantiality." Thus in *Janko* v. *United States*, 281 F. 2d 156, 163 (C.A. 8), evasions of approximately 32% and 37% of correct taxes were held to be substantial; and in *United States* v. *Cindrich*, 140 F. Supp. 356 (D.C. Pa.), an underpayment of some 20% was considered substantial. Indeed, the Government in this case sought to impress both courts below with percentage claims as to the understated tax, asserting in the District Court that the erroneous tax liability of $419.96 amounted to an evasion of "over 400% of his correct tax for that year"[6] and asserting in the Court of Appeals that the corrected tax liability of $375.49 demonstrated that petitioner evaded "well over 300% of his correct tax for that year, which is clearly 'substantial' under the rationale of the decided cases."[7]

A definitive delineation of these percentage factors and other "attendant circumstances" constituting the substantial understatement concept is essential if the existing confusion and conflict are to be eliminated.

IV

Does the Government have the burden of proving the relevant tax rate so that the jury may determine the

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[6] Government's Answer to Defendant's Motion for Judgment of Acquittal and, in the Alternative, for a New Trial, p. 4.

[7] Brief for the United States in the Court of Appeals, p. 56. Mathematically, it may be questioned whether any understatement can amount to more than 100%.

substantiality of any understated tax? In this case, the jury was asked to reconstruct petitioner's 1961 tax return, determine whether any tax was due thereon and decide whether any understated tax was substantial. To do so, the jury had to be able to calculate the tax due on what it conceived to be the proper net or taxable income. Yet that vital link in the evidence, necessary to any determination of a substantial tax deficiency, was completely lacking. And if such evidence be deemed critical to the Government's case, the District Court supplied neither answer nor substitute in ruling that petitioner's raising of the point was belated. Appendix B, p. 6a, *infra*. Such proof should be an affirmative obligation on the Government, whether or not the defense points out the deficiency.

The jury here was instructed to weigh the testimony of experts as it would the testimony of any other witness. Yet without any proof of the relevant tax rates, the jury could do little more than accept the tax calculation of the Government's expert witness. But the danger inherent in blindly accepting such a calculation was dramatically demonstrated by the plain error in the expert's calculations, an error which the jury could not have corrected without knowing the applicable tax rates.[8] And because of this inability to calculate the correct tax, the jury cannot be said to have evaluated the substantiality of any understated tax other than the

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[8] Under the 1961 Tax rates, as set forth in Vols. 1 and 3 of the 1961 Prentice-Hall federal tax service, if the taxable income was not over $2000 the tax was 20% of that taxable income; but if the taxable income was over $2000 but not over $4000 the tax was $400 plus 22% of the excess over $2000. Thus there would be a slightly different tax rate as to the erroneous taxable income of $2,099.81 ascribed to petitioner and as to the corrected taxable income of $1,877.43.

incorrectly calculated one of $419.96. The jury did not and could not consider the substantiality of the corrected tax figure of $375.49. And petitioner was denied the benefit of any conceivable feelings of jurors who might have thought that any figure under $400 was too insubstantial to warrant conviction.

V

What are the factors and circumstances relevant to evaluating the substantiality of a $375.49 tax understatement? The jury here was instructed to determine if the Government had proved that there was a willful attempt to evade "a *substantial part* of the income tax due *as alleged . . . in the indictment.*" [Emphasis added.] And it was told that the word "substantial" as here used depends upon "the facts, circumstances and conditions as shown by the evidence" and that any amounts of unreported taxable income or tax "greater than sums *reasonably small*, under the particular circumstances pertaining thereto, are substantial." [Emphasis added.]

But what amounts are "reasonably small" under the "circumstances" so as to constitute an insubstantial part of the tax due "as alleged . . . in the indictment"? The Court of Appeals offered no clue except to say that had petitioner been able to "knock out" two of the items of unreported income totalling some $1,500 the resulting deficiency "could hardly be called substantial."[9] And what are the facts, the circumstances

[9] Obviously, then, not every amount of tax due was considered "substantial." But it is difficult for anyone, especially a jury of non-tax experts, to calculate the tax due had two items of taxable income been "knocked out," especially in the absence of proof as to applicable tax rates.

and the conditions that are relevant to determining if $375.49 is "reasonably small"? Does the controlling fact or circumstance lie in a comparison of the $375.49 tax figure with the $3,350.45 tax understatement alleged in Count I of the indictment?[10] Does proof of a tax deficiency amounting to only 11% of that alleged in the indictment, a deficiency amounting to less than $400, permit a finding of a "substantial" tax understatement? Or should such comparisons be disregarded and the dollar amount of the understatement be viewed in isolation or left to the uncontrolled feeling of the jury?

It is important that some guidelines be established as to the basis for determining whether such an understatement is substantial. When the amount involved is relatively small by any standard, as $375.49 certainly is, and when the evidence as to unreported income is closely contested, as it was here, there is a risk of a wrongful conviction without such guidelines. If the "substantiality" test permits the jury to consider all possible considerations, does not the "substantiality" determination tend to become swallowed up by the finding of an intent to evade? If the test is to retain any vitality, must not limits be set as to the factors and circumstances that the jury may properly consider in evaluating "substantiality"? Moreover, because a determination that an understatement of tax is insubstantial may influence a jury's conclusion as to whether the

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[10] The Government was of course not bound to prove the understatement as alleged in the indictment. But the problem here relates to the comparison between what was alleged and what was proved and the effect that comparison has on the issue of substantiality.

understatement was willful,[11] it becomes appropriate to isolate more clearly the factors that pertain alone to the substantiality concept. Thus there is strong reason for this Court to review the judgment below.

CONCLUSION

Tax evasion prosecutions are a frequent occurrence, a fact which underscores the recurring nature of the problems presented by this case. Tax evasion defendants, as well as prosecutors and the lower courts, urgently need clarification of the substantial understatement concept to the end that criminal justice may be more effectively and fairly administered. For that reason, certiorari should be granted to review the judgment below.

Respectfully submitted,

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[11] "A tax due and owing must be a substantial part of the total tax as adjusted. Anything less . . . should be considered a conclusive presumption of a lack of intent to attempt to evade any tax." Kostelanetz and Bender, *Criminal Aspects of Tax Fraud Cases*, p. 5 (1957).